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Zubair Hasan

INCEIF; The Global University of Islamic Finance, Kuala Lumpur

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## Scarcity, self-interest, and maximization from Islamic angle

By

**Prof. Dr. Zubair Hasan**

INCEIF: The Global University of Islamic Finance, Malaysia



ISLAMIC RESEARCH AND TRAINING INSTITUTE  
A MEMBER OF THE ISLAMIC DEVELOPMENT BANK GROUP





## Islamic Development Bank (IDB)

### Establishment

The Islamic Development Bank is an international financial institution established in pursuance of the Declaration of Intent issued by the Conference of Finance Ministers of Muslim Countries held in Jeddah in Dhul Qa'dah 1393H (December, 1973). The inaugural Meeting of the Board of Governors took place in Rajab 1395H (July 1975) and the Bank was formally opened on 15 Shawwal 1395H (20 October, 1975).

### Vision

By the year 1440H Hijrah, IDB shall have become a world-class development bank, inspired by Islamic principles that have helped significantly transform the landscape of comprehensive human development in the Muslim world and help restore its dignity.

### Mission

The mission of IDB is to promote comprehensive human development, with a focus on the priority areas of alleviating poverty, improving health, promoting education, improving governance and prospering the people.

### Membership

The present membership of the Bank consists of 56 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of Islamic Cooperation (OIC), pay its contribution to the capital of the Bank and be willing to accept such terms and conditions as may be decided upon by the IDB Board of Governors.

### Capital

As of the month of Rajab 1431H, the Authorized Capital of the Bank was ID 30 Billion, and the Issued Capital was ID 18 Billion, of which ID 17.474 Billion was subscribed with ID 4.031 Billion Paid-Up.

### Group

At present the IDB Group is made up of Islamic Research and Training Institute (IRTI), International Islamic Trade Finance Corporation (ITFC), The Islamic Corporation for Insurance of Investments and Export Credit (ICIEC) and The Islamic Corporation for the Development of the Private Sector (ICD).

### Headquarters and Regional Offices

The Bank's headquarters is in Jeddah in the Kingdom of Saudi Arabia. Four regional offices were opened in Rabat, Morocco (1994), Kuala Lumpur, Malaysia (1994), Almaty, Kazakhstan (1997) and Dakar, Senegal (2008).

### Financial Year

The Bank's financial year is the lunar Hijra year.

### Accounting Unit

The accounting unit of the IDB is the Islamic Dinar (ID), which is equivalent to one SDR – Special Drawing Right of the International Monetary Fund.

### Languages

The official language of the Bank is Arabic, but English and French are also used as working languages.

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# Scarcity, self-interest, and maximization from Islamic angle

Prof. Dr. Zubair Hasan<sup>1</sup>

INCEIF: The Global University of Islamic Finance, Malaysia

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## Abstract

This paper clarifies some misinterpretations of three foundational concepts in mainstream economics from Islamic viewpoint. These are scarcity of resources, pursuit of self-interest and maximizing behavior of economic agents. It argues that stocks of resources that God has provided are inexhaustible. But important is the availability of resources out of stocks to mankind. Availability is a function of human effort and the state of knowledge about resources over time and space. In that sense resources are scarce in relation to multiplicity of human wants for Islamic economics as well. Self-interest must be distinguished from selfishness. The motive operates on both ends of human existence: mundane and spiritual. Its pursuit does not preclude altruism from human life. Counter interests keep balance in society and promote civility. Islam recognizes the motive as valid. Maximization relates to quantifiable *ex ante* variables. Uncertainty of future outcomes of actions makes maximization a heuristic but useful analytical tool. The concept is value neutral. What is maximized, how and to what end alone give rise to moral issues. Modified in the light of Shari'ah requirements the three concepts can provide a firmer definition for Islamic economics centered on the notion of *falah*.

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## 1. Introduction

I feel honored and privileged in presenting this ceremonial lecture to the distinguished academics, researchers and administrators who have spared time to grace the occasion with their presence. The topic I have chosen for my talk this evening may not look so cogent, but is in fact a compact structure of immense significance. Scarcity of resources, pursuit of self-interest, and maximization of gains together make the foundation on which is raised the superstructure of mainstream economics (Samuelson 1947).

The social order of Islam had been flourishing the world over for centuries before the modern capitalism appeared on the scene with the dawn of industrial revolution in England. It is seldom realized that the basic features of the capitalistic system were evolving all along during the era of Moorish Spain in Europe (Hasan 1992, p.239). For instance, the system like Islam allowed private ownership of property, granted freedom of enterprise and approved a free play of market forces in the economy. It also eulogized trade and held in high esteem business profits that Islam counted among the bounties of God. But these features of the Islamic import became increasingly distorted as capitalism advanced on the secular path and eventually won global status. Today there has been a

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<sup>1</sup> I am grateful to Dr. Waleed Addas who made some useful comments on an earlier draft. Nurhafiza Abdul Kader Maim, my Research Assistant and now PhD students at INCEIF also deserves a mention for her valuable help in the preparation of this lecture.

reversal in history: Muslim scholars oblivious of the past emphasize the affinities of the Islamic system along these lines as (if) borrowings from capitalism. Indeed, of late they see and seek the fulfillment of their aspirations in reforming capitalism, not in erecting the Islamic order as an alternative.<sup>2</sup> Is it not then queer that Islamic economists are divided on admitting that resources for want satisfaction are scarce, that human beings essentially seek to promote their own interest, and that they want to maximize their gains? Their position on these issues and their ramifications basic to economics remains *inconclusive* to put it mildly. I shall argue that these postulates have also to be the fulcrum of Islamic economics for survival. Required is a re-look at their content and character, not rejection.

For a clear understanding of economic analyses, prior reference to a methodological point may be helpful. Mainstream economics picks up its notions like consumption, production, firm, profit, demand, supply exchange, entrepreneur, growth and so on mostly from the bin of common parlance. But when out of these words of daily use the economists construct the ideal or the abstract types, to facilitate explanation or analysis the same words their meanings change, at times radically. Not many can always understand that economists may be talking about something quite different what the same word conveys to the man in the street. Even among the economists, differences of opinion can often be traced back to the divergent meanings in their minds of the same term they are using. This happens because the terms tend to assume different meaning depending on the goal of the model or the type of market structure one has in mind. For example, fiat money is wealth for the one who sees it in the pockets of individuals, but the same money is not wealth for the one who is talking of national income estimation. Islamic economists have to be conscious of this fact while commenting on Western ideas.

A brief explanation of historical bearings of the concepts under review may help clear the cobwebs and see the issues in a right perspective. This we do in the following Section 2.

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<sup>2</sup> For example, M. N. Siddiqi shifted from *the teaching of Islamic economics to teaching economics from Islamic perspective* (Hasan 1998a). Professor Khurshid Ahmad pleaded in a recent lecture (2007) that Islamic reforms in the field of economics have to be sought *within* the capitalistic framework. Also, the title of a recent book of Murat Cizaca reads: *Islamic Capitalism and finance*. The process of one-sided convergence has been hastened all the more by the imitative expansion of Islamic finance.

In Section 3 we explain the meaning of scarcity, its social implications and its Islamic import. Section 4 shows that pursuit of self-interest is ingrained in human nature and that Islam has no hesitation to recognize the fact. Section 5 is devoted to explain the maximizing behavior of economic agents and its relevance for Islamic economics. Finally, Section 6 contains a few concluding observations on the linkage between the three basic economic notions and their collective efficacy for Islamic economics.

## 2. Pre-Islamic context

Human beings have always desired and strived for improving their living conditions through increase in consumption ever since Adam put his foot on the planet Earth. They instinctively desire more and more of goods for use compared to what they command resources to produce. Thus, scarcity of resources in the face of unrestricted proliferation of human wants (including spiritual) gives rise to activities that we study in what has long come to be known as economics. But a study of economics, as of any other subject, always relates to a *time span* — big or small — on its never ending evolution path. It is vital to learn about the times when Islam joined the caravan for taking account of how it did or can contribute to the discipline.

It would perhaps be appropriate to start with the contribution of Greek thinkers to the history of economic thought, the leading lights among them being Hesiod, Democritus, Xenophon, and Aristotle. In their era (800 BC — 322 BC) the population of the world must have been tiny and scattered. Resources were plentiful at that time. Scarcity was not usually in the reckoning, nor was efficiency the focus of attention. Markets had arrived but played no role in the allocation of resources which was regulated by authority, custom, or faith. As life was simple, there were few topics to discuss. And, yet the Greek provided valuable insights into economic theory; notable was their cohesive presentation of the *natural law*. Not a few of their contributions influenced not only Islamic thinking but left their foot marks far beyond on the path of human knowledge.

Two important themes emerged from the writings of Greek thinkers. One relates to the sort of approach required for a social inquiry. They believed that it was inappropriate to sort out human activities into categories — economic or non-economic, to illustrate — for



inquiry and investigation. They held that social problems were interwoven as are shades in a painting and can best be studied in relation to one another as parts of a whole. This view has misled many Islamic economists into believing that Islam too insists on integrated studies of the social phenomena to arrive at correct understanding of the issues and design appropriate policy prescriptions. Note that authentic records regarding world population are not available for the seventh century at the point when Islam made its advent on the scene. Table 1 shows that it was around 200 million at the dawn of Christianity and not more than 275 million for the year 1000. Thus, putting the world population at 235 million for the year 650 may not be a wild guess.<sup>3</sup> The size still tiny as it was - allows the inference that social environment of early Islamic scholars may not have been much different from that of Greek writers and their immediate followers. Thus, they too could advocate for and indulge in blanket sort of writings, taking a unitary view of the social phenomena. But the approach was by no means an eternal faith imperative.

**Table 1 World Population Growth**

Year	1	1000	1500	1650	1750	1804	1850	1900	1927
Population	200m	275 m	450 m	500 m	700 m	1.0 b	1.20b	1.60 b	2.00 b
Year	1950	1960	1970	1980	1990	2000	2010		
Population	2.55 b	3.00 b	4.00 b	4.50 b	5.30 b	6.12 b	6.81 b		

Source: Matt Rosenberg, About.com Guide [<http://geography.about.com/od/obtainpopulationdata/a/worldpopulation.htm>]

Today the world population is more than 7 times of what it was in 1750 that is more than a thousand years after Islam. The modern era has witnessed a vast expansion in numbers as also in knowledge. These expansions have been accompanied by a rapid development in the means of transportation and communication, making the globe smaller in terms of time and space. Consequently, humanity has produced more output since 1950 than it could during its entire existence prior to that year (AI 3, 2006). On the other side of the fence, war and violence, crime and corruption, tyranny and terror, poverty and plunder, affluence and bankruptcy, rapacious exploitation of natural resources and environmental calamities stare mankind in the face as never before. Can one address the innumerable, varied, and gigantic issues at one go in a unified treatise the Islamic economists advocate

<sup>3</sup> The population of Saudi for 2008 is estimated at 22 million excluding foreign residents and no more than 2 million for Mecca and Medina put together. Also, it grew at a fast pace only after the discovery of oil in the land during the 1960s. However, based on the data cited the population of the area now constituting Saudi Arabia may not have comprised of more than several thousands of people on a safe estimate.

for? Human brain has limitations, computers too. □Indeed, it was the very ability of man to make an abstract separation of human activities that represents the part of intellectual apparatus necessary for the □birth□of economics and other social sciences.□[Landreth □ Colander, p.25]

Scarcity of resource or their allocation to various uses not being important for the Greek, their second theme focused attention on the questions of fairness, justice and equity. They examined exchange relations and prices essentially from an ethical prism. The dominance of moral concerns could well be understood in economies where market activity still remained inconsequential. Thus, early Islamic scholars too focused on the issues of fair play and justice in the same vein as their predecessors. However, with the emergence of markets as the driving force of fast developing economies in the West during more recent centuries, rationalism replaced faith in choice-making and ethical concerns perforce took the back seat. But it is interesting to note that the significance of ethical conduct in business is now resurfacing in their literature on corporate governance; thanks to the worldwide devastations the current financial crisis has brought in its train and the mountains of moral bankruptcy it has unveiled. Islamic economics has an opportunity to demonstrate its healing touch but only if and if only Muslim countries could produce substantive illustrations of *Islamic norms at work*. Political leadership in these countries is not by and large in a position to meet the Islamic aspirations of their people for reasons extrinsic to their thinking.

The fact that Islamic norms are not shaping realities in Muslim countries has led to much misplaced argumentation between Islamic economists on the one hand and their mainstream critics on the other. Both have been oblivious to one principle of simple logic that one must compare the ideals of his system with the ideals □*not realities* - of the other. Islamic economists invariably err in comparing the ideals of their system based on what *ought to be* with *what is* of capitalism in operation.<sup>4</sup> Likewise, their opponents,

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<sup>4</sup> For example, suppose one had a magic wand that could be used for making competition *perfect* in all sorts of markets □the ideal of capitalism. Then, one could presumably venture the demonstration that much of the divergence between the ideal Islamic economic structures and that of capitalistic order □evaporated into thin air.

largely from the West, attack Islamic *ideals* for erecting an economic system as having failed citing the conditions as they *are* in Muslim countries. Much of the criticism of Islamic economics emanating from the West - Timor Kuran being prolific<sup>5</sup> - falls in this category. The critics fail to realize that the long colonial past of these countries and its later continuation in different garbs seldom allowed their leaders the breath or space for implementing the Islamic agenda for social development even when they possibly so desired. Let one realize what Islam requires Muslims may not always be doing and what they are doing may not always be Islamic.

Islamic economists can contribute to the effort by eschewing subjectivity coloring their thought process and develop an objective understanding of mainstream economics so as to make more widely acceptable contributions to the discipline. Furthermore, required is the emphasis on the substance rather than on the form of what Islam stands for. It is the understanding, not antagonism that could eventually win the day.<sup>6</sup> Let us have a look at the foundation stones of mainstream economics from this angle.

### 3. Scarcity of Resources

The Greek writers did not care to give scarcity any precise meaning or explore its ramifications as in their era population was small and resources plentiful. But there were things as certain types of plants or rocks they did not come across so often: they were rare i.e. very small in quantity. It was the experience of *rarity* that eventually led to the notion of *scarcity*. Senior (1790 – 1864) was presumably the first economist to lay stress on scarcity and regarded it as the basis of value. *Rarity* was not enough for a thing to assume

<sup>5</sup> Kuran (1989, p.178) makes a rather eristic remark on my demonstration of how profit sharing ratio would be determined in Islamic finance under certain assumptions (Hasan 1985). He writes: "Another author, using a mathematical model says that the shares are to be determined through the interaction of the supply and demand of contracts – as if, once again, an equilibrium allocation could never be lopsided" Now, I nowhere talked about the qualitative aspect of equilibrium let alone holding *as if* the equilibrium ratio can or will always ensure a just division of profit between the parties. At the same time, is it not a fact that most of the theoretical constructs in economics rest on virtue-free equilibrium heuristics?

<sup>6</sup> It was in this context that I have long been advocating a "step-by-step approach to Islamizing economics as opposed to an "all-or-nothing" approach implied in some major works on Islamic economics (Hasan 1988, 1998 and 2002). Haneef and Furqani (2004, p.31) find me "wrong" on the point. To him, the latter approach never existed. I respect his opinion but differ from him. I stick to my position which incidentally finds clarification and support in a recent work. See M. Omar Farooq (2006, pp.43-44)

value; it must also satisfy some want. It must be rare in terms of utility. It was the same sense in which Walras employed the term scarcity later (Gide and Rist 1953 p. 357).

Scarcity as the base of value wore a new import when Lionel Robbins in his influential work, *An Essay on the Nature and significance of economic science* (1932) projected the notion as the definitional base of economics.<sup>7</sup> He carried its relationship with human wants a step further. To him, resources including time could not be scarce unless they had alternative uses (pp. 13-14). This attribute of scarcity forces on human beings the imperative of *choice making* in the face of multiplicity of wants: wherever there was a problem of choice, there was an economic problem. Robbins thus saw scarcity as an aspect in human activities widening the scope of economic science to cover a whole gamut of social problems including even marriage, crime, corruption and election.

There is room for presumption that a remark in the *Essay* might have led Islamic economists to deny the existence of resource scarcity altogether. Robbins wrote:

The ends are various. The time and means for achieving these ends are limited and capable of alternative applications. At the same time the ends have different importance. Here we are sentient creatures with bundle of desires and aspirations with masses of instinctive tendencies all urging us different ways to action. But the time in which these tendencies can be expressed is limited. The external world does not offer full opportunities for their complete achievement. *Life is short. Nature is niggardly*. Human activity has not the independence of time or specific resources. There are only twenty four hours in the day. We have to choose between different uses to which they may be put [Essay: from pages 12-15, emphasis added].

Presumably, attributing niggardliness to nature as responsible for scarcity of resources the Islamic economists took as an affront to God's benevolence. If this presumption were correct, the reaction, in my view, was uncalled for. The statement was a manner of speaking, not an element meriting consideration in Robbins's argument. Its elimination would not subtract even an iota from the thesis of the *Essay*.<sup>8</sup>

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<sup>7</sup> The second edition of the *Essay* was published in 1935. References given in this work are from a 1945 reprint of this version downloaded from the internet.

<sup>8</sup> In fact, Iqbal the illustrious Urdu poet and a flag bearer of Islam smelled much more rebellious than Robbins in not a few of his poetic compositions. See this, for example: No wine remains in your jar; are you not (O God) my cup filler? If the thirsty gets just drops of dew from the ocean, it is (an act of) *niggardliness*, not sustenance [Author's translation].

It is difficult to identify Islamic economists who do or do not approve the notion of scarcity as valid for the discipline. Many appear non-committal or take it for granted. Some are found on shifty grounds. But there *are* scholars who have voiced resource scarcity as inadmissible from Islamic perspective. Monzer Kahf (1992, p.115) feels that economic problem is not of scarcity but is caused by human laziness and neglect. The petite work of Mohammad Akram Khan (1994 p. 44-45) provides a leading illustration of projecting a similar viewpoint. I had done a review of the book (Hasan 1996) and found little difficulty with its content save the position Khan took on the scarcity of resources.

Much of the confusion on the scarcity of resources in Islamic economics seems to arise from the difference in the prisms writers use to look at the issue. Those who like Khan denounce resource scarcity see it from a cosmic angle and from that angle correctly argue that God has been benevolent and merciful. He has stocked the earth (and the heavens) with his inexhaustible treasures for all times to come not only for human beings but for other creatures as well (Qurʾān 2:29; 7:10; 14:34; 15:20-21). Also, God has made resources in a mold that they would readily submit to human command and effort. The argument is irrefutable; it stands on testimony from the holy Qurʾān (For example 7:10; 14:32-33).

However, the point missing in the above argument is that the divine *provision* of stocks, however inexhaustible, is not a sufficient condition for the *availability* of resources to human beings in desired measure at any time or space. Existence of resources is necessary but it is their availability to mankind that lends content and meaning to the notion of scarcity as the basis of economics. The availability of resources to human beings depends on the state of their knowledge and expands as they strive to discover more and more about their uses, location, methods of extraction, and cost effectiveness through continued learning research and action.

The holy Qurʾān not only talks of God's bountiful resources but also informs us that he alone is the source of knowledge. Divine wisdom releases it to those who seek; not all at once, but bit by bit so that people are not carried away by pride and arrogance. The

proposition in Khan (1994) that scarcity of resources is merely a man-made phenomenon resulting from the wasteful use and mal-distribution of resources is erroneous. These factors only aggravate scarcity, they do not *cause* it. In fact, scarcity of resources in terms of their availability as explained above is conceivably a part of divine scheme to spur human beings into action for searching their living in the land of God and at the same time be tested in how they do it.<sup>9</sup> Life for that reason is a trial in this world. The history of human civilization is the history of the march of human conquest of nature.<sup>10</sup> In essence, it is the history of pushing outward relentlessly the frontiers of scarcity through unceasing research, inventions and innovations in science, technology and social management (Hasan 1996, p. 357).

### **Knowledge versus scarcity**

Knowledge is the weapon of mankind in the fight for making resources available from the store of nature and the potential expansion of knowledge certainly knows no limits. The race of all races on Earth has indeed been between the growth of knowledge and resource availability for producing material requisites of well-being in the face of ever increasing population. Malthus and Ricardo - the pessimists - were obsessed with the fear of an impending hell unless human beings adopted measures to keep their number in check.<sup>11</sup> Their protagonists like Seligman saw in the birth of a child not only a mouth demanding food but also a pair of hands capable of adding to its output. The optimists were elated by the hope of a coming paradise. The elation emanated from the sight of industrial revolution already flying high on the wings of scientific inventions and innovations.

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<sup>9</sup> Presumably, this was one reason why God stopped the falling of Manna from the skies. But Robbins employs the event to exemplify the possibility of human beings remaining temporarily free of scarcity (*Essay* p.11).

<sup>10</sup> See the Box 'Economics the Happy Science' in Landreth and Colander (1994, p.103)

<sup>11</sup> The ghost of scarcity their logic and evidenced unleashed continues to haunt humanity even today and has resulted over the centuries in chaotic top heavy demographic structures which some nations are now trying to correct. Family planning cannot be a public policy in a Muslim country in view of the assuaging words of the Qur'ān: Kill not thy children in the fear of want. We have provided for you. We shall provide for them too (17:31 See also 11: 7; 51:58).

In this non-stop race of knowledge against scarcity the former has so far been winning, more so over the past 150 years. Efforts are being made to quantify knowledge and measure its rate of growth. A recent work tried to fix the components of knowledge and how each could be measured. The investigation put to test the hypothesis if knowledge doubled every five years. In this context 23 variables were identified as determinants of knowledge. The measurement was the number of years each component took to double itself. It is found that various components have different time span for doubling but with right input investment we could double knowledge every 5 years (League Table 2007). In any case, there has been an explosive development in knowledge after the Second World War, more so in the field of science and technology.

The explosion has kept mankind ahead of scarcity in the race. The population of the world in 1999 was 2.7 times of its size in 1950. During the same period the real GDP of the world measured in international US dollars has increased almost 7 folds while the per capita income improved about 3 times. Within this broad spectrum, there have of course

Table 2: Per capita income data for selected years in US \$ million

Country Types	Years				
	1990	1995	2000	2005	2010
Developing Countries (a)	840	1090	1230	2363	2781
Developed Countries (b)	19590	24930	27510	34962	38360
Gap: (b) - (a)	18750	23840	26280	32599	35579
(b) / (a)	23.32	22.87	22.37	14.80	13.79

Source: Construction is based on data in World Development Reports: Developed countries include High Income classification. Developing countries include Low and Middle Income classifications. Notice that absolute income gap is still increasing even as relative differences are on the decrease.

been vast difference over time and space, the Muslim countries especially lag far behind. They possess a major chunk of global natural resources - existing and potential - but contribute no more than 7 - 8 percent of the world GDP. They are essentially sellers of resources not their users. This correlates well with their meager contribution to the stock

of knowledge in the modern era. The reversal of ranks is rather lamentable for a community whose religion started with instructions to read.

The victory that mankind has so far achieved in the race against scarcity is not a cushion to sleep on. It is a race where temporal setbacks keep human beings constantly on steam for staying triumphant. But worrisome is the fact that success has come at a cost that mankind could notice rather late in the day. The rapacious use of natural resources has resulted in an almost irreversible environmental degradation.

### **Scarcity and environment**

The holy Qurʾān informed mankind that God has created things in measured proportions and they are held together in a delicate balance; it warned them not to indulge in mischief so as to disturb the balance.<sup>12</sup> But the warning went unheeded. The environmentalists continue to express dismay on the decaying health of the planet. Diminishing biodiversity, shrinking supplies of fresh drinking water, the vanishing of virgin forests, falling agricultural yields, and increasing frequency of natural calamities all threaten to make human life miserable on the planet if not extinct as time rolls by.

In price formation, markets treated only those resources as scarce which had opportunity cost and firms have to pay for them. But there are some natural resources like fresh air and water<sup>13</sup> that firms use not only to produce goods and services but also for disposing off the waste that production process emits. With the growth of population there are hardly any inputs that are available for production free of cost. Environmental problems arise not from the use of resources the firms pay for producing valuable goods and services but from the release of wastes □poisonous liquids, gases and solids □into the air, water and earth. The disposal of waste imposes costs on people in various forms such as enhanced medical bills for which no one compensates them. These social costs do not

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<sup>12</sup> See for example Qurʾān 6:3; 30:41; 39:5; 54:49; 67:3-4

<sup>13</sup> In the beginning when population was small the list of such free goods was long including land, forest products, fruits, flowers, honey, grass, water to name a few were all freely available. The list went on shrinking fast with the growth of population and the resultant expansion of human wants and production.



pass through the market (Silva et al 2009); they are *external* to it. Arnold Coase's model based on creating property rights in environmental goods and let the polluters and sufferers bargain in the market for compensation is valid in theory but efforts to put it into operation in the US failed for a variety of reasons. Nations have repeatedly failed to agree on how to face the environmental challenges summed up in climate change. Be it as it is but an extension of scarcity notion to cover environs and make polluters pay for the damage they cause is an imperative for the resolution of environmental issues. Figure 1 explains how we can internalize social costs and make them pass through the market to curb pollution.

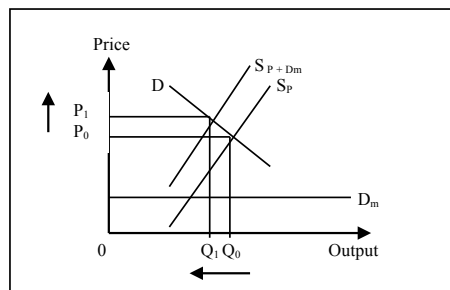


Figure 1: Taxing polluters to cover damage cost would raise price reduce output and conserves resources

Here,  $D$  is the demand curve for the commodity in question and  $S_p$  is the supply curve based on private costs.  $D_m$  is the external cost the producers of the commodity impose on society. It is assumed to remain unchanged whatever be the level of output for simplicity. The market price is determined at  $P_0$ . If we add  $D_m$  to private cost  $P$ , the supply curve will shift upward to  $S_p + D_m$  expressing social cost. Increase in cost will raise price to  $P_1$  and that would reduce output from  $Q_0$  to  $Q_1$ . The theory is clear; if producers could somehow be made to pay for the damage they cause, environment can improve. Missing are the political will, cooperation and collective action

Finally, scarcity is the essence of life; a part of the divine scheme to make people work and run the affairs on Earth. In the absence of scarcity what meaning would one put on patience, tolerance, and cooperation? Who would work for whom and why? Why would people hoard wealth or need condemn the act? What shall be the need or form of societal organization? Above all, will economics exist as a social science; if yes to what end? In

fact, it is the scarcity of resources that gave meaning and significance to the debate on the efficacy of pursuit of self-interest as the driving force of economic activities in the world.

#### 4. Pursuit of self-interest

People seek to promote their living through increased want satisfaction. Wants being unlimited, the scarcity of resources forces people to keep self-interest in the forefront. But the priority does not imply a denial of the existence of other motives including altruism as affecting human conduct<sup>14</sup> nor does it demand their blockade. Economics as a science dealing with social behavior, studies economic activities *en mass* —the crowd, not the individual. Mainstream economists maintain that of the various motives which affect human conduct the pursuit of self-interest tends to over-ride others; it is relatively more universal and stable. Thus, self-interest spurred by scarcity emerged as the focal point in economic modeling and analyses.

Islamic economists made a mistake in accepting the bifurcation of human motives into self-interest and altruism that initially emanated from the West. In the Islamic faith man is bipolar in creation: a combination of dust and divine. He has traits both noble and ignoble residing and fighting *within* his own person. Islam recognizes this fact. Thus, the Shari'ah encourages people to acquire and enjoy all good things in life in gratitude of Divine benevolence. However, they are instructed to observe moderation in consumption and avoid waste.<sup>15</sup> If people in their greed cross the limits, the pursuit of self-interest requires containment, not rejection. After all, why should the believers meet their religious obligations —pray, spend in the way of God, fast, go for the pilgrimage and do good deeds if not in *self-interest*: that is for seeking the pleasure of their Creator so as to

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<sup>14</sup> For instance Adam Smith wrote: "However selfish so ever man may be supposed, there are evidently some principles in his nature which interest in the fortune of others and render their happiness necessary to him though he derives nothing from it except the pleasure of seeing it" (Coase 1984, p.546).

<sup>15</sup> Khan and Mirakhor (1992, p.4) regard the pursuit of self-interest both as an obligation and right of an individual flowing from the Islamic concept of justice.

avoid the punishment of fire after death. Indeed, the Qur'an instructs them to work for that end.<sup>16</sup>

Pursuit of self-interest demands that one should be conscious of the interest of others and should avoid hurting them. The requirement invokes mutual respect and calls for cooperation - not conflict - for promoting the interest of each other. On this the following quote from Adam Smith's *Wealth of Nations* is indeed illuminating.

It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves not to their humanity but to their self-love, and never talk to them of our necessities but of their advantage.

We are immersed in a social milieu of opposite (self) interests which can stay in harmony only on the basis of reciprocal accommodation. There seems to be some sort of affinity in the deep between self-interest and the moral conduct. Ironically, the best defense against self-interest is self-interest. 'Cause no injury, receive no injury' is a well-known Islamic dictum. Thus seen, pursuit of self-interest ushers in morality; it promotes civility and consideration for others. Even altruism stems from that root. Evil makes virtue look valuable.

Self interest is invariably treated identical to selfishness but a line does separate the two. Self-interest can be pursued within the ambit of morality which selfishness would always violate. In a race every participant attempts to surge ahead on the basis his own strength; he is promoting self-interest. However, if he puts his hand on the shoulder of a rival going ahead and pulls him back to win the race, he is the selfish defying the rules of the game. Zola Budd - the South African British runner - was momentarily suspended on a suspicion of tipping in an incidence during the 3000 meter race in the 1984 Olympics at Los Angles.<sup>17</sup> The demarcation line between self-interest and selfishness is thus very fine as *intention* is the pen that draws it.

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<sup>16</sup> But seek with the (wealth) which Allah has bestowed on thee the home of the Hereafter, and forget not thy portion of lawful enjoyment in the present world (28:77).

<sup>17</sup> See BBC Report dated August 11, 1984 on their news website for the full story.

Self-interest and selfishness may not though be identical in principle but in practical affairs of the world the demarcation is blurred beyond recognition. However, it is not for this reason that the pursuit of self-interest ran into disrepute even in mainstream economics. There were other difficulties too. First, society being a collection of individuals, there has been a strong presumption in economics that whatever promotes individual interest would automatically promote that of the society as well. Adam Smith not only brought self-interest to the fore in economics, he is also the author of the *harmony of interest* thesis. He wrote in *Wealth of Nations*:

An individual generally neither intends to promote the public interest, nor knows how much he is promoting it. he intends only his own gain, and he is in this, as in many other cases, led by an *invisible hand* to promote an end which was no part of his intention. ... By pursuing his own interest he frequently promotes that of the society more effectively than when he really intends to promote it.

Both logic and empirics prove that the harmony of interest thesis is questionable. For example, the much talked about win-win situations these days need not always be conducive to social well-being unless the division of gains can also be shown as equitable. The specter of crushing poverty and sticky inequalities in income distributions within and across nations provide ample evidence falsifying the proposition.

The second follows from the first. It is the postulate that a person is a rational being if he works to promote *only* his own interest. This view has long been dubbed in economic discourse as egoistic rationality. Its criticism is scathing at times is well-known and much documented in the literature; I need not reproduce it here. In Islamic economics the proposition led to the coinage of a few reaction smelling terms: some sought to replace the hand of God for the *invisible hand* in Adam Smith. Others attempted to paint the picture of an Islamic man to pale the mainstream economic man into insignificance. Such efforts were presumably amateurish, if not absurd. On a sober note, the evaluation of the proposition in Syed Omar Agil (1992) is quite balanced. But it was Professor A. K. Sen (1971) who in his *Rational Fools* put the final nail to the coffin of the proposition.

One cannot but enjoy the sarcasm the very title of the essay carries.<sup>18</sup> That it has been reproduced several times and in different places is a measure of its vitality.

Finally, not only is the pursuit of self-interest definitive for the notion of rationality, there is a further insistence that conduct is rational only when it single mindedly works for maximization of economic gains □ consumers must maximize utility and producers profit. Maximizing behavior has attracted much criticism in mainstream economics and its Islamic counter part just rejects the principle as unacceptable. We examine the debate in the following section. We shall take profit maximization as an illustrative case.

### 5. Maximizing behavior

Maximizing behavior may relate to an economic magnitude such as utility or profit; it may also relate to a non-economic magnitude like goodwill of neighbors or the pleasure of God. To denounce the conduct in the first case and appreciate rather promote it in the second must make the Islamic stance internally inconsistent. The point has not received due attention in Islamic economics.<sup>19</sup>

The pursuit of profit maximization is apparently avaricious and seems to conflict with moral conduct. For this reason maximization norm has received much criticism in the mainstream literature itself. Still, it survives and for two reasons. First, price formation under varying market conditions is difficult to explain without a maximization hypothesis both on the demand and supply sides of the market. Second, the critics of the assumption have not so far been able to produce an alternative rule of behavior having the same explanatory or predictive value as maximization carries.

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<sup>18</sup> The figure of the young handsome Sen as I first saw him on September 9, 1965 chairing a selection committee meeting rises in my imagination even today as that interview brought me to the once famous Delhi College of the University of Delhi. The institution was later renamed as Zakir Husain College and is now housed in a new building on Nehru Marg, New Delhi.

<sup>19</sup> There are Islamic economists who approve rather grudgingly the act of profit maximization but join the consensual condemnation of utility maximization. The confusion is further confounded when there are still others who change their position without notice.

However, most Islamic economists denounce a maximizing behavior. A typical condemnation comes from M. N. Siddiqi (1998). Among the basic points of departure for Islamic economics from its mainstream counterpart, he accords first priority to the rejection of the behavior aimed at maximizing private gain on the part of an economic agent. He writes:

The maximization hypothesis is not very helpful in understanding the economy, any economy. But it is entirely unacceptable as an aid to the understanding of an Islamic economy, any Islamic economy. Even some understanding of Islam and some compliance with its teachings is sufficient to create a society which defies the maximization hypothesis. Something else is needed (p. xiii, see also pp. 17 and 28).

This is rhetoric pure and simple. The author provides little reasoning or documentation for his opinion and says not a word on what the "something" that he mentions could possibly be (Hasan 1998).<sup>20</sup>

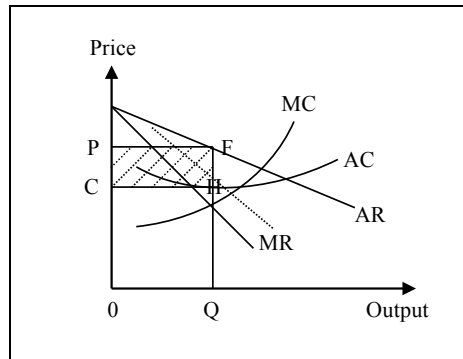
Islamic economists usually plead for some reasonable or fair profit as a Shari'ah alternative to the maximum. One comes across diagrams showing how fair profit can replace the maximization norm. I have shown the weaknesses of such diagrams earlier (Hasan 2002, p. 116 n.20). Here I shall argue why the fair profit norm cannot be used for price determining process in free market operations.

Under perfect competition price is determined by the forces of aggregate demand and aggregate supply. Individual firms have no pricing power; they are just price takers. In the long-run firms are able to make only normal profit which is just equal to implicit costs or opportunity costs of the factors owners supply to the firm. No Islamic economist will probably dispute that normal profit is fair profit. In the short-run, can earn profit in excess of the normal. But it is soon competed away. In any case firms do not get it all by design.

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<sup>20</sup> Siddiqi (1992) approves the use of conventional analysis of a firm's equilibrium via the marginal cost and marginal revenue curves based on the maximization of profit assumption. But he believes that the assumption can be relaxed to incorporate objectives relating to the good of society. How he does not show.

The long run position is no different even when competition is not perfect and firms enjoy some pricing power; profit is again normal and therefore fair. In the short run the price that would give only fair profit is difficult to determine. Consider the following Figure 2. Here the profit of the firm  $\square$  shaded area PCHF is the maximum under given market conditions. Now, the firm following the advice of Islamic economists wants to have only fair profit not the maximum the figure shows. Its difficulty is that in the absence of an externally available bench mark it does not know by how much it should shrink the rectangle PCHF to make profit fair? It is willing to reduce the price but does not know what price cut would make profit fair? Again, the reaction of customers as also of the rivals to a price reduction is difficult to gauge. A professor in one of his books tried



**Figure 2:** Short-run equilibrium of the firm under Imperfect competition

to show how profit could be made fair. In a Figure as the one above he shifted the marginal revenue curve MR to the right  $\square$  see the dotted line - keeping AR un-shifted. The modification reduced price and increased equilibrium output. This was clearly untenable and misleading.<sup>21</sup>

The moral code of sellers going for a fair profit, however defined, could work in a small time social scenario (Refer to Section 2 above) when production was mostly to fill standing orders and adding a margin to the procurement cost of inputs was a common trade practice. It was also easy to have an idea of fairness in transactions. Today, we are

<sup>21</sup> The Professor did not suggest any rule for the extent of MR shifting to make profit fair, let alone defining such profit. He ignored the important fact that there is a mathematical relationship between the slopes of straight line marginal and average revenue curves; one cannot be moved without an appropriate movement of the other.

in an era of mass production for the markets. The number and variety of goods has gone up tremendously. Producers or sellers are subject to market discipline (or indiscipline). They have limited control over the determination of the prices for their goods. Also, let us ask if the Islamic banks are able to use mark-ups yielding only fair profits? The fact is that the concept of a fair price or profit is largely external to modern business. Needed information is rarely available, let alone the seeking of it. Purchasers' associations, NGOs and ultimately the state authorities work as watch dogs for the people on fair trade practices including, quality, price or profit. The matter falls in the public policy domain. The limitations of a fair profit notion in theory and practice take us back to the maximization of profit issue.

Profit maximization has two broad aspects: motivational and operational. The key questions are: do firms want to maximize their profits, and if yes, can they really achieve the goal? Much controversy has centered on these issues in the mainstream literature.<sup>22</sup>

On the question of motivation, it is agreed that in the case of small owner-operated firms profit maximization has always been the guiding star of the decision making process over time and space. But with the rise of modern corporations to dominance the objective has long paled into insignificance. Managers are well compensated professionals. The common shareholders are a scattered lot. They are not interested in knowing nor have the means to know if the profits of their company are indeed being maximized. They are happy with dividends so long as they find them satisfactory. Managers are interested more in their reputation, peace of mind, leisure and unsuspecting rivals. Corporations, after crossing a profit point, become more interested in growth of variables like size, sales and share of the market. However, careful observation and analyses of inside happenings in corporations will convince that the clouds of alternative goals shine only in the light of old good moon of profit behind them. In any case, other motives that are claimed to have replaced profit maximization in large corporations are mostly situation specific; they lack its global character and stability.

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<sup>22</sup> For a literature review and fuller discussion on these points see Hasan (1975) Chapter IV 'Profit maximization as business objective' (pp.59-82).



Presumably, we face greater difficulties on the feasibility side of the fence. Profit for maximization lies in the future; it is an *ex ante* concept. Future consequences of most decisions are uncertain. It is thus argued that even if firms desire maximum profits they do not have the means of knowing which of the alternative courses of action □ often overlapping - would ensure achievement of the goal; realized profit may fall short of the expected (maximum); it could even be negative. But uncertainty has to be taken as a fact of life like sun or rain. It can make most rational decisions look idiotic if expectations fail. But that does not bar people from peeping into the future. All planning in human life would be non-existent if we were so possessed with the possibility of expectation failures due to uncertainty. Profit maximization is a *directional* concept. It only says that due to scarcity of resources firms should not miss if there is a legitimate opportunity to enhance profits. Maximization spurs to efficiency.

Maximization *per se* is value neutral; what is maximized, how and to what end are the questions that can assign to it ethical labels □ good or bad. Also, it is a mathematical concept inapplicable to variables that cannot be measured and divided infinitesimally. On that criteria profit maximization is a heuristic notion. Roads carry goods far and near to facilitate growth but on their own add nothing to them. Likewise, maximization has no content yet it is a powerful tool for economic analysis; it moves markets to equilibrium. It can be used with legal provisions to safeguard against potentially undesirable consequences. Shari'ah provides ample protection to both consumers and the hired factors of production against profit seeking at their cost. Islamic economics need not throw away the baby with the bath water (Hasan 1992).

## 6. Concluding remarks

In sum, I have tried to correct some misconceptions concerning a few terms □ scarcity of resources, pursuit of self-interest and maximization of gains □ in Islamic economics. These concepts are inter-related as the foregoing discussion has amply shown. They constitute minimal tools needed to explain and investigate economic phenomena to help formulate theories with predictive ability needed to guide economic policy. The objective

of this effort is to end diversity of opinion and develop some sort of a definitional consensus regarding these foundational stones of economics including Islamic.

The misconceptions presumably cropped up for two reasons. First was the lack of adequate knowledge about mainstream economic theory and policy to earlier Islamic scholars. Second was the desire to demonstrate after independence from the foreign rule that Islamic economic thinking was independent of and superior to the Western positions. Both hindered the growth of Islamic economics and triggered secular antagonism against the nascent discipline.

Remember that the source of *all* knowledge is God; the stock of knowledge is thus divine in origin. It is only the criteria of choosing from the stock that can and does bifurcate it into categories like secular and non-secular or religious and non-religious. Faith system determines choice in the case of religion. The rules for Islamic selection are: accept all pieces of knowledge that Revelation palpably approves. Reject all knowledge that clearly conflicts with Islamic norms. The vast area between the two ends God has left in his mercy open to believers' discretion on the generic principles of *facility* or *expedience*. The knowledge of economics coming from mainstream sources must be sifted and passed through the Islamic filters for acceptance.<sup>23</sup>

This I have done with regard to three basic and closely related analytical tools in mainstream economics – scarcity, self-interest and maximization – and shown that they can be incorporated in Islamic economics with advantage after interpretative modifications to meet the Shari'ah requirements. The modification allows having a firmer and more logical definition of Islamic economics as under.

*Islamic economics is the subject that studies human behavior in relation to multiplicity of wants and scarcity of resources with alternative uses so as to maximize falah that is the well-being both in the present world and the hereafter.*

The definition underlines the spirit of the following prayer from the Holy Qur'an that the believers so invariably address to God

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<sup>23</sup> Islamic economics must accept contributions from other disciplines and both science – positive and normative as well as art to help realize human well-being here and in the hereafter (Addas 2006, Chapter 7).

“Our Lord! Give us in this world that which is good  
and in the hereafter that which is good and save us  
from the torment of fire”. (2: 201).

God knows best.

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## Islamic Research & Training Institute (IRTI)

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The Islamic Research and Training Institute (IRTI) was established by the Board of Executive Directors (BED) of the Islamic Development Bank (IDB) in conformity with paragraph (a) of the Resolution No. BG/14-99 of the Board of Governors adopted at its Third Annual Meeting held on 10th Rabi-ul-Thani, 1399H corresponding to 14th March, 1979. The Institute became operational in 1403H corresponding to 1983. The Statute of the IRTI was modified in accordance with the resolutions of the IDB BED No.247 held on 27/08/1428H.

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P.O. Box 9201, Jeddah 21413  
Kingdom of Saudi Arabia  
Tel: (00966-2) 636 1400 Fax: (00966-2) 637 8927  
Home page: <http://www.irti.org> Email: [irti@isdb.org](mailto:irti@isdb.org)





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P.O. Box 9201, Jeddah 21413  
Kingdom of Saudi Arabia  
Tel: (00966-2) 636 1400

Fax: (00966-2) 637 8927  
Email: [irti@isdb.org](mailto:irti@isdb.org)  
[www.irti.org](http://www.irti.org)